IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

CRANE COMPANY, a Corporation,
Appellant,
vs.
FIDELITY TRUST COMPANY, Trustee, a Corporation, and WASHINGTON-OREGON CORPORATION, INDEPENDENT ELECTRIC COMPANY, a Corporation, and WILLIS D. HOAG,
Appellees.

No. 2768

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

BRIEF OF FIDELITY TRUST COMPANY, TRUSTEE, AND OF THE TEMPORARY RECEIVER OF WASHINGTON - OREGON CORPORATION, IN OPPOSITION TO THE CLAIM OF APPELLANT FOR PRIORITY.

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Allen & Lamborn Printing Co., Tacoma, Wash.

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THE FACTS

Crane Company, from time to time between January 1st, 1911, and May 31st, 1914, sold pipes, fittings and gas and water equipment to the Washington-Oregon Corporation, which was during such period engaged in the operation of electric railway systems, light and water systems in the states of Washington and Oregon.

In May, 1911, and before any of the account of Crane Company involved in this litigation arose, the Washington-Oregon Corporation, which had been doing business for only a few months, executed a mortgage or deed of trust to Fidelity Trust Company, as trustee, to secure an authorized bond issue of Washington-Oregon Corporation to the amount of $5,000,000.00, said bonds being 6 per cent bonds, and the interest maturing on the first of April and the first of November in each year. Said mortgage constituted a lien upon all property of every nature and description then owned by Washington-Oregon Cor-

poration and thereafter acquired by it, and upon the rents, issues and profits of all of such property. (Amended Bill of Complaint, Transcript p 3) (All of the allegations of the amended bill of complaint in the foreclosure suit are made a part of Crane Company's Petition, Section VI.)

This mortgage was duly filed and recorded in the various counties of the states of Washington and Oregon where the Washington-Oregon Corporation owned property. (Amended Bill, par. 10.)

After the recording of this mortgage, and thus after all persons dealing with the Washington-Oregon Corporation were put upon notice of the prior lien of the holders of bonds issued under this mortgage, Crane Company continued to furnish materials to the Washington-Oregon Corporation. The materials thus furnished are mentioned in Schedule A, annexed to Crane Company's Amended Petition.

The purchase price of the materials furnished by Crane Company amounted to about $100,000.00. Most of the materials furnished by Crane Company and all of the materials comprised in the present claim (with the exception of an item of $195.89), were furnished subsequent to the recording of the Fidelity Trust Company mortgage. Washington-Oregon Corporation has paid to Crane Company in all the sum of $89,871.24 on account of the total $100,929.05 of materials furnished by Crane Company. (Amended Petition, Tr. 26.)

In some instances the parties agreed that payments made by Washington-Oregon Corporation should be applied on specific items which were not the oldest items. The balance of the account is $11,-202.70.

On June 1st, 1914, a balance of account was struck, and six notes were given for the unpaid balance in the principal sum of $13,223.25; one of which was paid July 7, 1914, by the Washington-Oregon Corporation. This was about three weeks prior to the appointment of the receiver herein. (Amended Petition, Par. VIII, Tr. p 31.)

As shown by the Amended Petition the present claim of Crane Company is based upon materials furnished during the following periods prior to the appointment of the temporary receiver (July 31, 1914):

$56.03 within 6 months prior to the receivership.
$00000 in more than 6 months and within one year.
$3,038.01 more than one year and within 18 months.
$45.65 more than 18 months and within 2 years.
$7,898.64 more than 2 years and within 2 years 6 months.
$58.23 more than 2 years and 6 months and within 3 years.
$195.89 more than 3 years and within 3 years and 3 months.

NATURE OF MATERIALS

Appellant's Classification

In appellant's brief it divides the items of its claim into three groups, (1) materials furnished which were purchased and used for repairs and replacements; (2) materials which were purchased and used for making service connections; (3) materials which were purchased and used in making extensions and betterments and for the laying of new mains to take the place of old mains.

Before making a classification which we think would fit the facts, we desire to point out very briefly the inaccuracies of fact in the classification made by the appellant. The facts are not always fully or accurately stated in the brief, and reference should be made to the stipulation. (Tr. 51 and Exhibits.)

We first consider the items under the heading "1" of the brief . All of these items are claimed by appellant to constitute "repairs and replacements."

1. Exhibit 1 in the brief is apparently Exhibit 6 in the stipulation, and it is simply marked "Replacements." Exhibit 2 of the brief is apparently Exhibit 7 in the stipulation, and is simply marked "Service Connections." Exhibit A-3 and A-5 are stated in the stipulation to have gone into stock and to have been used for service connections; these are not repairs nor are they replacements. Exhibit A-4 was used for an extension to the S. P. & S. shops, to which reference is more fully made in the stipulation, and is more fully explained in our own classification; it is not a repair nor a replacement, and it is not known whether it was actually used. A-7, as shown in the stipulation, was designed for use "in connection with services from old mains or extensions of old mains." A-14, A-16, A-18 and A-22, were all items of *betterments* at the Springs. A-15 was definitely an item of *extension,* in order to tie up to City hydrants in connection with the contract with the City of Vancouver. B-4, B-8 and B-12 were items of replacements. B-18 was an item of repairs *and* service connections, but they are not segregated. Exhibits C-1 and C-2 are both for replacements. C-3 was a *betterment* made necessary in order to pump direct during the re-lining of the reservoir and were necessary

to permit the cleaning of the reservoir. C-4 was a *betterment* to prevent the shutting off of large residence districts in case of breaks on the 6-inch and 4-inch mains at Chehalis. C-6 was a *betterment* to promote the more economical operation of the water system at Chehalis. D-1, $43.44, is shown to be for repair and maintenance of pipes at Centralia; and D-4, $222.18, a part of the *building and installation of new mains* to take the place of old mains which were out of repair and leaking and a part of which were installed preparatory to hard-surfacing the streets, the old mains being inadequate to serve customers. The court will see, by an examination of the items of Subdivision 1, on pages 17 and 18, appellant's brief, that the items were not for repair but were *for replacing, the making of service connections, the making of betterments, and the making of extensions*—the latter being for the S. P. & S shops or to connect with the City hydrants.

As to many of the items in appellant's Subdivision 1 and in the subsequent subdivisions, it should be noted that they were put in stock, and the stipulation does not disclose, and it is not known whether they were used prior to the receivership or up to the present time.

2. As to Subdivision 2 of the appellant's classification, beginning on page 19, claimed to be for service connections, the following should be noted: The third item of Exhibit A-4 was used in connection with the S., P. & S. *extension,* and were, of course, extensions themselves. The same thing is true of item on the twentieth page of the brief $154.03. Exhibit A-8 was used on "new or old mains," but they are not segregated. Exhibit A-10 was used in

connection with "new or old mains." Exhibit A-13 was used for the S., P. & S. *extension*. Exhibit B-1 was put *in stock* for future connections. Exhibit B-3 was used in making service connections from *new mains* at the time the same were laid in order to eliminate future cost of taking up and replacing pavement. Exhibit B-9 was used for repairs, service extensions, making taps to new mains, at the time the same were laid, for future connections; they were deemed expedient to eliminate future cost of tearing up pavement and putting same in later. Exhibit B-10 was partly placed in stock, to be used on service connections, and the balance was used in replacing old with new pipe prior to paving. Exhibit C-5—the items were placed in stock and checked out for new service to customers, partly for old and partly for new mains; the same is true of Exhibit C-7, except that some portion of that was used to connect dead ends; the same is true of C-8, except that no part of it appears to have been used for connection of dead ends. Of all of these items, a very considerable part were placed in stock and, as stated in the stipulation, it is not known in many cases whether the items were actually used or not prior to the receivership, or since. (See Exhibits A-1, A-4, A-8, A-11) A large proportion of the items were actually used as stated for extensions. (A-8, A-17, A-19, and others.) Some of them were used for the S., P. & S. extension. (See A-4, 2nd and 5th items, A-13 and others.)

3. Apellant's Subdivision 3, beginning at page 23, is "for materials used in laying and replacing old mains and in making betterments." As to these items, we ask the Court to note, as of Exhibit A-6, that the whole item was for the S., P. & S. extension

and that the company had no pipes on this street at all. There was an old 1½-inch main on a part of this street belonging to somebody else, and apparently used by the corporation. This pipe only extended about seven hundred (700) feet. A new extension was put in by the company to reach the S., P. & S. Company's shops, and the item of $1,868.78, being Exhibit A-6, was pipes for that extension. A-12 was used in connection with the same extension. A-20 was an extension to meet the City fire hydrants in accordance with the contract with the City; this was a distance of approximately seven hundred feet. The stipulation states that the entering into of this contract was a "condition precedent to the granting of the franchise," (Exhibit A, p. 6). This was *an extension.* The balance of the pipe was put into stock and was to be used in new mains. *It is not stated whether it was actually used or not.* B-11 is for "new mains in place of old mains," etc. B-13, 14, 15 and 16 were a part of the same improvement. Exhibits B-2, 5 and 17, were, as shown in the stipulation, used in connection with new mains. Exhibit B-6 was a part of a twelve-mile extension. As to these items, the Court will notice that in each case the goods were used for laying new mains or replacing old mains; and in the case of replacement, they were substantially a re-building. As the burden of proof is on the appellant the claim fails whenever any undetermined part of any item fails to be shown to be in a class entitled to preference.

Our Classification:

In the subsequent portions of this brief we propose to establish that under no conditions have items of construction been allowed preference; that this

rule applies to a reconstruction and applies to an extension of existing systems; and that so-called service connections constitute an extension of an existing system. And we further propose to show that relief is not allowed by the courts excepting for day to day supplies, and that betterments are not within the rule. Consequently, we have gone through the items of the account as explained annd interpreted by the Stipulation and have made a classification of each item, which we think is accurate, with reference to the state of the law which we propose to establish.

The nature of the materials furnished by Crane Company and the uses to which they were put, (the burden of showing which matters rests upon Crane Company) so far as shown in the Stipulation as to the facts, are as follows:

(a)—Gas equipment designed for use in connecting mains with customers:

(A-1)	Aug. 14, 1911	$58.83
(A-4)	May 20, 1912	39.79
		$89.72

The property comprising the gas system was sold in October, 1912, and, further, we have no record or means of ascertaining whether they were actually used prior to the sale of the gas plant, or whether a part was sold with the gas plant. Stipulation, A-1 and A-4.

(b)—Water equipment (and in part gas equipment (A-3) consisting of pipes, cocks, claims, etc., placed in stock and used in connection with new service on old mains and on extensions of mains at Vancouver (Exhibit A):

(A-3)	May 11, 1912............	$ 95.72
(A-4)	May 20, 1912............	21.31
(A-4)	May 20, 1912............	48.75
(A-4)	May 20, 1912............	36.25
(A-5)	May 24, 1912............	63.82
(A-7)	June 19, 1912	176.80
(A-8)	June 25, 1912	110.87
(A-9)	July 1, 1912............	9.10
(A-11)	July 16, 1912............	110.14
(A-10)	July 10, 1912............	45.00
(A-17)	May 3, 1913............	302.25
(A-19)	May 10, 1913............	300.08
(A-21)	June 12, 1913...........	25.20
		$1,347.29

All of these goods involved in the Crane Company's account which were used at Vancouver, except goods referred to in Exhibits A-6 and A-20, were first placed in stock and then were taken from stock as occasion required. In the above statement, unless otherwise noted in the Stipulation, it is not known whether the goods were all used prior to the receivership. Stipulation, Exhibit A, p. 6:

At Hillsboro (Exhibit B)

(B-7)	May 10, 1911 (Stock)	$195.89
(B-9)	June 4, 1912 (Stock)	38.29
(B-14)	July 12, 1912.............	79.58
(B-18)	May 22, 1913 (Stock)	16.95

At Chehalis (Exhibit C)

(C-5)	May 1, 1913 (Stock)	$173.89
(C-8)	June 27, 1913 (Stock)	78.59
		$252.48

At Centralia (Exhibit D)

(D-3)	May 20, 1911..............	$171.38
(D-5)	April 25, 1913............	176.84
		$348.22

At Kelso (Exhibit E)

(E-1)	May 17, 1912 (Stock)	$41.72
	Total materials under (b)	$4,320.42

(c)—Fire Hydrant System at Vancouver:

(A-2)	May 9, 1912	$ 49.00
(A-15)	Apr. 22, 1913	127.03
(A-20)	May 20, 1913	805.26
		$961.29

The Washington-Oregon Corporation made a contract with the City of Vancouver whereby the company agreed to connect its main with the fire hydrants of the City.

The invoice of May 20, 1913, for $805.26, covers 1,505 feet of 6-inch Matheson pipe; 700 feet of this pipe was used for new mains on Fourth Plain Avenue, such new mains running from the old main at the corner of East Reserve and Fourth Plain Avenue, easterly a distance of approximately 700 ft. The balance was put in stock and was to be used in new mains.

(d)—Extension of water system to shops of Spokane, Portland and Seattle Railway Company at Vancouver:

(A-4)	May 20, 1912	$ 21.87
(A-4)	May 20, 1912	154.03
(A-6)	June 19, 1912	1,868.70
(A-12)	July 17, 1912	13.16
(A-13)	July 23, 1912	85.50
		$2,143.26

These goods consisted of 4,502 feet and 11 inches of 6-inch Matheson pipe for extensions of water main on 39th Street from the intersection of Kaufman

Avenue to the shops of the S., P. & S., a distance of about 1,600 feet. The pipe used up to the shops was about 1,600 feet in length, and the length of the pipes in around the shops took up the balance. There was a $1\frac{1}{2}$-inch pipe running along 39th Street from the corner of Kaufman Avenue about 700 feet westerly. This pipe belonged to some other proprietor who had formerly maintained a water system, and was at the time of the extension used by the Washington-Oregon Corporation. This $1\frac{1}{2}$-inch pipe was taken up at the time that this new installation was made. (Stipulation, Exhibit A-6.)

The extensions of mains herein outlined were necessary to meet the demands for water in the unserved parts of the city and such as were necessary to meet the demands of the customers. (Exhibit A, p. 6.)

(e)—Betterments at the Springs in Vancover consisting of gate valves, and other water equipment.

(A-14)	April 18, 1913	$149.66
(A-16)	May 1, 1913	53.44
(A-18)	May 9, 1913	45.90
(A-22)	June 23, 1913	18.00
		$267.00

The betterments at the Springs herein referred to were made necessary to provide adequate and suitable supply of water and effective means of delivering the same to the customers. (Exhibit A, p. 6.)

(f)—Water mains, replacing old mains, at Hillsboro:

(B-8)	June 26, 1912	$ 168.55
(B-11)	June 26, 1912	1,680.04
(B-13)	July 1, 1912	28.50
(B-14)	July 1, 1912	28.50
(B-15)	July 1, 1912	33.95
(B-16)	July 1, 1912	18.30
(B-10)	July 1, 1912	79.58
(B-3)	July 20, 1912	66.78
(B-4)	July 29, 1912	116.41
(B-2)	July 30, 1912	15.39
(B-17)	Aug. 1, 1912	28.55
		$2,264.55

The observations made in the Stipulation under the invoice of June 26th, 1912 (B-11), for $1,680.04, seem to be applicable to all these materials.

As shown by the Stipulation, this bill covers mains laid in streets prior to paving; six-inch Matheson pipe laid on 2nd Street from 4th to 6th Streets; 3rd Street from Base Line to Washington; 4-inch pipe laid at intersection 5th and Main, 2nd and Oak hydrant extensions. Fittings used on same job. Three oval base valve bases now in stock. These mains were laid in place of old mains, part of which were worn out, and part of which City insisted should be removed. (Exhibit B-11.)

(g)—Water pipe and fittings in Sain Creek extension:

(B-6)	July 23, 1912	$392.40
(B-1)	July 30, 1912	41.76
(B-5)	Aug 5, 1912	17.10
		$451.26

This twelve-inch pipe (used in B-6) was a part of the gravity system being installed in accordance with an ordinance of the City of Hillsboro under which Washington-Oregon Corporation was operat-

ing, a copy of said ordinance being hereto attached, and marked "Exhibit B-19." This system extended from the City of Hillsboro through the town of Forest Grove and thence to Sain Creek, a distance of about ten miles. The former franchise under which the Washington-Oregon Corporation operated at Hillsboro had expired and this new franchise was granted on certain conditions, as appear from said franchise. (Stipulation, Exhibit B, pp. 2 and 3.)

(h)—Pipes and equipment used in substitution of steel pipes for wood pipes at Chehalis:

(C-1)	May 20, 1912	$130.41
(C-2)	June 19, 1912	535.28
		$665.69

The wood pipes were out of repair and the steel pipe was necessary under the pavement.

(i)—Water gates for use during re-lining of reservoir at Chehalis:

(C-3)	May 1, 1913	$42.84
		$42.84

These were necessary to pump direct on 8-inch line during re-lining of reservoir and also necessary to clean the reservoir.

(j)—Water gates for emergency use at Chehalis:

(C-4)	May 1, 1913	$111.24
		$111.24

Used to prevent shutting off of large residence districts in case of breaks on the six- and four-inch mains.

(k)—Water valve at power plant at Chehalis:

(C-5)	May 12, 1913	$57.83
		$57.83

Eqipment necessary to facilitate better and more economical operation of pumps at the power plant.

(l)—Pipes at Chehalis:

(C-7)	May 22, 1913	$551.11
		$551.11

All this pipe was placed in stock. Part used at Vancouver for service connections. 2,100 feet of this pipe was laid from 5th and Pacific Avenue to Chehalis Avenue to John and Pacific. 680 feet for replacements from St. Helens Avenue and Chehalis-Centralia Road to shingle mill. 2,100 feet of pipe was used for the purpose of connection of dead ends of mains necessary to obtain proper circulation and to deliver pure water.

(m)—Water eqipment for repair and maintenance of pipes and mains at Centralia:

(D-1)	May 14, 1912	$ 43.44
(D-4)	June 15, 1912	222.18
		$265.62

(n)—Water main extensions at Centralia:

(D-2)	May 17, 1912	$356.70

Used in extensions of mains already laid. These extensions were laid and installed in order to meet the demand of the consumers and customers of water in the City of Centralia, Washington, and were only such as were necessary in order to supply the water as demanded by the consumers.

(o)—Water pipe and fittings used in extensions at Kelso:

(E-1)	May 17, 1912	$ 41.72
(E-2)	July 16, 1912	186.36
		$228.08

These materials were used in constructing mains to the Kelso and Wallace schools in said city, in order to furnish water to said schools. Said Washington-Oregon Corporation operated under a franchise making it an obligation to supply said schools with water.

(p)—Miscellaneous water equipment at Kelso:

(E-3)	May 6, 1913	$1.88
		$1.88

The following is a summary of the foregoing classes of materials, showing the use to which such materials were devoted and the time prior to the receivership within which the latest item of each class of such materials was furnished:

Service Extensions.

(a)	Gas eqipment for service connections	$ 89.72	2 yr. 2 mo.
(b)	Water equipment for service connections	4,320.42	2 yr. (note)

NOTE: Except items aggregating $1074.10, which were furnished somewhat over one year prior to receivership.

Main Extensions

(d)	Extension to S. P. & S. shops at Vancouver	$2,143.26	2 yr.
(g)	Sain Creek extensions	451.26	1 yr. 11 mo.
(n)	Water main extensions at Centralia	356.70	2 yr. 11 mo.
(o)	Water Main extensions at Kelso	228.08	2 yr.
(l)	Water main extensions at Chehalis (Part service connections at Vancouver)	551.11	1 yr. 2 mo.

BETTERMENTS.

(c) Fire hydrant system at Vancouver	$ 961.29	1 yr.	2 mo.
(e) Betterments at the Springs, Vancouver	267.00	1 yr.	1 mo.
(i) Wood gates at Chehalis..	42.84	1 yr.	3 mo.
(j) Water gates at Chehalis	111.24	1 yr.	3 mo.
(k) Water valve at Power House, Chehalis	57.83	1 yr.	2 mo.

RECONSTRUCTION

(f) Water mains replacing old main at Hillsboro ..	$2,264.55	2 yr.	
(h) Pipes for replacing mains at Chehalis	665.69	2 yr.	

REPAIR

(p) Miscellaneos water equipment at Kelso	1.88	1 yr.	2 mo.

The gas system at Vancouver was sold in October, 1912 (Exhibit A-1, Stipulation); the water system at Chehalis, the water system at Centralia and the water system at Kelso were sold prior to the beginning of the foreclosure. (Amended Bill Exhibits D and E).

The aggregate of the above is $12,512.87; there was due June 1st, 1914, thereon, $13,223.25, and notes were taken. (Par. VIII. pet). One note was paid a few days before the receiver was appointed, leaving notes in the principal sum of $11,000.00 unpaid.

POINTS AND AUTHORITIES.

1

While under a few specified and limited circumstances the Supreme Court has declared that unsecured claims were entitled to priority over claims secured by mortgage, the doctrine has been confined

within narrow limits and the Supreme Court and lower courts have constantly warned litigants against the tendency to seek to displace vested liens. The tendency is to narrow the doctrine, not to broaden it.

> *Thomas vs. Western Car Co.*, 149 *U. S.*, 95, 37 *L. Ed.*, 663;
>
> *Bounds vs. Ry. Co.*, 58 *Fed.*, 473;
>
> *Virginia, etc., Coal Co. vs. Central Ry. Co.*, 170 *U S.*, 355, 42 *L. Ed.*, 1068;
>
> *Illinois Trust & Sav. Bank vs. Doud,* 105 *Fed.*, 149;
>
> *Kneeland vs. American Loan & Trust Co.*, 136 *U. S.*, 89, 34 *L. Ed.*, 379;

II

Appellant's cases under head of "Nature and Character of Preferential Claims" are not in conflict with the foregoing statement. These cases will be separately discussed hereafter.

III.

The mere fact that the franchise required construction or betterments, or that the value of the mortgaged property was increased, does not entitle the claimant to preference.

> *Illinois Tr. Co. vs. Doud,* 105 *Fed.*, 123;
>
> *Rodger Ballast Car Co. vs. Omaha*, 154 *Fed.*, 629;
>
> *State Trust Co. vs. Kansas City,* 129 *Fed.*, 455,
>
> *And cases in following subdivision.*

IV.

Preferences are allowed only for current supplies exclusive of betterments and exclusive of new construction or reconstruction.

Rhode Island Locomotive Works vs. Continental Trust Co., 108 *Fed.,* 5;

Central Trust Co. vs. Colorado R. R., etc., Co., 200 *Fed.,* 85;

Thomas vs. Western Car Co., 149 *U. S.,* 95, 37 *L Ed.,* 663;

Lackawanna Iron & Coal Co. vs. F., L. & T. Co., 176 *U. S.,* 298, 44 *L. Ed.,* 475;

Todelo R. R. Co. vs. Hamilton, 134 *U. S.* 295, 33 *L. Ed.,* 905;

Porter vs. Pittsburg, etc., Steel Co., 120 *U. S.,* 649, 30 *L. Ed.* 830;

Reyburn vs. C. G. F. & L. Co., 29 *Fed.,* 561;

City Trust Co. vs. Sedalia, 195 *Fed.,* 845;

National Trust Co. vs. Townsend, 95 *Fed.,* 850, *op.* 859-863;

V.

There can be no diversion except against those claims entitled to a preference.

Toledo R. R. Co. vs. Hamilton, 134 *U. S.,* 296, 33 *L. Ed.,* 905;

Porter vs. Pittsburg, etc., Co., 120 *U. S.,* 649, 30 *L. Ed.,* 830;

Rhode Island Locomotive Co. vs. Continental Tr. Co., 108 *Fed.,* 5;

Rodger Ballast Car Co. vs. Gas Co., 154 *Fed.,* 629;

Central Trust Co. vs. Colorado Co., 200 *Fed.,* 85;

Thompson vs. Railroad Co., 132 *U. S.,* 681.

VI.

In the absence of special circumstances claims otherwise entitled to preference will be allowed such

preference for six months only prior to the appointment of a receiver.

Westinghouse vs. Kansas City So. Ry. Co., 137 *Fed.*, 26;

Southern Ry. Co. vs. Carnegie Steel Co., 176 *U. S.*, 257, 292;

Fosdick vs. Schall, 99 *U. S.*, 255, 25 *L. Ed.*, 343;

Bound vs. Ry. Co., 58 *Fed.*, 473;

Thomas vs. Peoria, etc., 36 *Fed.*, 819;

Thomas vs. Cincinnati, 91 *Fed.*, 195;

Westinghouse vs. Kansas City, 137 *Fed.*, 41;

Chicago & Ogden vs. U. S., etc., Co., 225 *Fed.*, 943;

Blair vs. St. Louis, 22 *Fed.*, 471;

Finance Co. vs. Charleston, 52 *Fed.*, 678;

International Trust Co. vs. Townsend, 95 *Fed.* 850;

National Bank of August vs. Carolina, etc., 63 *Fed.*, 25;

Central Trust Co. vs. East Tennesse Ry. Co., 80 *Fed.*, 624;

Guaranty Trust Co. vs. Galveston, etc., R. R. Co., 107 *Fed.*, 311;

State Trust Co. vs. Kansas City, 129 *Fed.*, 455;

Moore vs. Donahoo, 217 *Fed.*, 177;

Title Insurance Co. vs. Home Telephone Co., 200 *Fed.*, 263;

Gregg vs. Metropolitan Trust Co., 197 *U. S.*, 183, 49 *L. Ed.*, 717.

VII.

It is not settled whether the doctrine is applicable to a water company

Short, Law of Railway Bonds and Mortgages, p 594;

Wood vs. Guaranty Trust Co., 128 *U. S.,* 418, 32 *L. Ed.,* 472;

Ford cs. Central Trust Co. 70 *Fed.,* 144;

Louisville & Nashville R. R. Co. vs. Memphis, etc., Co., 125 *Fed.,* 97;

Wheelen vs. Enterprise Trans. Co., 175 *Fed.,* 214.

ARGUMENT

Counsel for appellant seems to rest his case upon the proposition that appellant is entitled to preferential treatment because the supplies, as he claims, increased the value of the security of the bondholders. Counsel predicates this contention upon the statement that these supplies were in some part necessary to preserve the business of the company, in that certain franchises would have been forfeited had there not been certain new construction. This of course does not embrace all the items of appellant's claim, but so far as applicable under the stipulation this is one of the equities on which he expects to prevail; furthermore, appellant seems to contend that the mere fact of the putting in of the supplies increased the security of the bondholders to that extent and therefore it is entitled to treatment in preference to bondholders and of course in preference to the ordinary creditors. Before discussing these or any of the contentions of the counsel in detail we call the attention of the Court to the fact that appellant's position not only requires it to assume

the burden of proof as to facts, but also requires it to overcome the presumption in the mind of the Court that an unsecured creditor is not entitled to outrank a secured creditor, nor is an unsecured creditor presumed to outrank the other unsecured creditors. The presumption of course is that the bondholders having mortgage security are prior to all the unsecured creditors. It s also a natural presumption that all of the unsecured creditors stand on a basis of equality. Since it appears by the allegations of the complaint that the Washington-Oregon Corporation has several hundred thousand dollars of unsecured indebtedness, the burden is upon the intervenor to show some appealing equity before it can be lifted from the level of like claims and be put in a class of superiority over such claims and over the mortgage

I.

The doctrine invoked by appellant is an equitable doctrine applied only where there are special equities, and its indiscriminate application has been steadily denied by the courts. The tendency is to narrow it not to broaden it.

The doctrine in the case of *Fosdick vs. Schall* was *dictum,* but has been generally accepted as authority for the proposition that expenses for current supplies for a period of six months prior to the receivership shall be allowed priority, but the Supreme Court of the United States has in many cases since that time warned litigants and courts against the indiscriminate displacing of contract liens.

In the case of *Thomas v. Western Car Co.,* 149 U. S., 95, 37 L. Ed., 663, Mr. Justice Shiras quoted from *Miltonberger vs. Logansport,* 106 U. S., 286, 27

L. Ed., 117, and from *Kneeland vs. American Loan & Trust Co.,* 136 U. S., 89, 34 L. Ed., 379, the matter quoted being germane to a discussion of the claim for preference in this case. We ask the Court to look at the *Thomas* case and the cases therein referred to. The position of claimant for car rental there under consideration was held by the Court to be "very different from that of workmen and employes or of those who furnish day to day supplies necessary for the maintenance of the railroad." The following language from the *Kneeland* case is quoted with approval:

> "The appointment of a receiver vests in a court no absolute control over the property and no general authority to displace vested contract liens. Because in a few specified and limited cases this court has declared that unsecured claims were entitled to priority over mortgage debts an idea seems to have obtained that a court appointing a receiver acquires power to give preference to any general and unsecured claims * * * * Can anything be conceived which more thoroughly destroys the sacredness of contract obligations? One holding a mortgage debt upon a railroad has the same right to demand and expect of the court respect for his vested and contracted priority as the holder of a mortgage on a farm or lot * * * No one is bound to sell a railroad company or to work for it, and whoever has dealings with a company whose property is mortgaged must be assumed to have dealt with it on the faith of its personal responsibility and not in anticipation of subsequent displacing of the priority of the mortgage liens. It is the exception and not the rule that such priority of liens can be displaced. We emphasize this fact of the sacredness of contract liens for the reason that there seems to be grow-

> ing an idea that the Chancellor, in the exercise of his equitable powers, has unlimited discretion in the matter of this displacement of vested liens."

Referring to the *Thomas* case: The Circuit Court of Appeals in *Bounds v. Railway Co.,* 58 Fed., 473, in an opinion rendered in a case in which Chief Justice Fuller sat, used this language:

> "The Supreme Court has recently in Thomas v. Car Company indicated the narrow limits to which an equity court should confine itself in allowing any unsecured claim to displace vested contract liens. Wages due employes, current operating expenses, current balances of ticket and freight money arising from indispensable business relations, and similar current debts accruing within ninety days, are recognized as among the limited class of claims which, in its discretion, the court may allow to have priority."

See also the opinion of Mr. Justice White as to the need for great care in extending this doctrine, in the case of *Virginia, etc., Coal Co. v. Central Ry. Co.,* 170 U. S., 355, 42 L. Ed., 1068, where claim for coal purchased and used in operating railroad was allowed, but where the court expressly endorsed the intimations contained in the *Kneeland* case and the *Thomas* case, *supra.*

In the case of *Illinois Trust & Savings Bank v. Doud,* 105 Fed., op. 149, all the cases up to that time are reviewed by Judge Sanborn in an opinion which seems to us to be as illuminating as any opinion that can be found. The court's conclusion is in this language:

> "The test of the preferential equity of a claim is its consideration. If its consideration was a *current expense of the operation of the mort-*

*gaged property which inured to its benefit, and which was incurred in the ordinary course of its business within a limited time anterior to the appointment of the receiver, the claim may be preferred * * * If the consideration of a claim is not a part of the current expense of the ordinary operation of the mortgaged property, but is a part of the expense of constructing a permanent addition or improvement to it out of the ordinary course of its operation, neither the fact that it tended to conserve and improve the property and increase the security of the mortgagee, nor the fact that it was necessary to keep the mortgagor a going concern, nor the fact that the mortgagor pledged or mortgaged the current income, to secure it, will give the claim a preferential equity over the lien of a prior mortgage."*

In considering the claim of the intervenors in that case, where their supplies had gone into the construction of a new power house and machinery thereof, Judge Sanborn uses this language:

"While there are *dicta* in some of the earlier opinions of that court (notably in Fosdick v. Schall) upon which a plausible argument that a claim for material or money furnished for a permanent improvement to the mortgaged property may be preferred to a prior mortgage, there is no decision of that court to that effect or adverse to the principles established and affirmed by the lines of cases opening with Dunham v. Railway Company, 1 Wall. 254, 267; 17 L. Ed. 584, and closing with Lackawana Iron & Coal Company v. Farmers Loan & Trust Company, 176 U. S. 298, 44 L. Ed. 475."

The court then states the doctrine, as he understands it fully, and we ask the court to read this case in full.

The case is authority on the proposition that

materials for extensions (as items c, d, e, g, l, o, as well as all service extensions) and betterments (as items e, i, j, k) are not entitled to preference.

The cases are so numerous that we cannot hope to touch them all but believe that the cases referred to as illustrative actually show the state of the law, and they are to be distinguished from the few cases where the courts have proceeded upon the theory that the test was whether the property was benefited, as distinguished from whether the supply was an actual current supply.

II.

Appellant's Cases Under Head of "Nature and Character of Preferential Claims"

An examination of the cases cited by the appellant on this point shows that they are not in conflict with the rule as stated by us. We will briefly refer to each of the cases:

Fosdick v. Schall, 99 U. S., 255, 25 L. Ed., 343. A claim for preference was disallowed and the remarks of the court were in way of *dictum.* Since there was no occasion to apply the doctrine which was stated to exist, the case cannot be considered any test of what constitutes operating expenses.

Fosdick v. Car Company, immediately following the case of *Fosdick v. Schall,* was one where the claim of the vendor for certain cars, or their cost value, was allowed not on any equitable theory, but upon the theory that the vendor retained the ownership of the cars and when the cars were included in the foreclosure sale the vendor was of course entitled to retake the cars or their value.

Moore v. Donahoo, 217 Fed. 177, in this Circuit, is one where the Master found that the claim which accrued within six months immediately preceding the appointment of the receiver "on account of labor done and materials furnished in the ordinary course of business for the normal maintenance and operation of the railroad and which it was reasonable to expect would be paid out of the current operating income, etc." aggregating a certain sum of money. The character of these claims were not in controversy; but if it had been, the doctrine of the court is all in favor of our contention. The claims which were allowed a preference were claims which were purely operating claims. The actual holding of the court is that such claims incurred within six months are entitled to preference to the extent only where there has been a diversion.

Farmers' Loan & Trust Co. v. K. C. W. & N. Ry. Co., 53 Fed. 187. This is a decision by Judge Caldwell, circuit court of Kansas, and was a case wherein the court had as a condition of the receivership imposed the payment of certain obligations. Some of these obligations apparently were for labor and supplies furnished in the construction as well as in the operation of the road. No distinction was made or considered between construction and operation but the claims were sustained not because they are entitled to preference under the rule, but because if they are not entitled to come under the rule "No one can complain so long as the debts allowed come within the terms of the order." The court evidently takes exception at the action of the bondholders in seeking to protect their right after their trustee had consented to the making of the order, and from the whole opinion it is obvious that this act of the trustee was

the basis of the decision. Even if the decision be considered, however, as a decision independent of the action of the bondholders in consenting to the preference, it is clear that the case is not in accordance with the authorities and is one of the few cases where the Federal courts have departed from the well settled rule that materials or labor for construction do not entitle claimant to preferential treatment.

The Supreme Court in the *Miltenberger case* (106 U. S. 286, 27 L. Ed. 117) distinguished between claims which arose prior to the receivership from those which arose during receivership, and said on this point:

> "The payment of such debts stands, *prima facie,* on a different basis from the payment of claims arising under the receivership, while it may be brought within the principle of the latter by *special circumstances.* It is easy to see that the payment of unpaid debts for operating expenses, *accruing within ninety days,* due by a railroad company suddenly deprived of the control of its property, due to operatives in its employ, whose cessation from work simultaneously is to be deprecated, in the interests both of the property and the public, and the payment of limited amounts due to other and connecting lines of road for materials and repairs and for unpaid ticket and freight balances, the outcome of indisepnsable business relations, where a stoppage of the continuance of such business relations would be a probable result, in case of non-payment, the general consequence involving largely, also, the interests and accommodation of travel and traffic, may well place such payments in the category of payments to preserve the mortgaged property in a large sense." etc.

The *Miltenberger* case was a case where the Supreme Court had under consideration the question

of priority of obligations incurred by the receiver, and also the questions concerning a priority of obligations prior to the receivership; and this case was the case referred to in the case of *Gregg v. Metropolitan Trust Company*, 49 L. Ed. 717, 197 U. S. 183, where the Supreme Court recognized payments made by the receiver as a matter of business necessity, as distinguished from payments which would be equally meritorious, but which were not required to be made to preserve the business of the company. It is to be borne in mind that in the Miltenberger case the court was considering the validity of obligations which had been incurred *by the receiver* as a matter of business necessity. The holding that the receiver should properly pay the freight bill where he could not continue an indispensable interchange arrangement unless the freight bill was paid, is not at all a holding that such a freight bill in itself is entitled to a preference. As stated in the argument, in the particular receivership now under consideration, bills for power were paid by the receiver under the order of the court because under the contract for furnishing power there was danger that the entire supply would be cut off unless prompt payment of all bills was made. The suppliers of this power were perhaps not entitled to a preference because of the nature of the supply, but they were in position to enforce a payment or by their action cause a very great loss to the trust. So, as in the Miltenberger case, it was necessary to make the payments to laborers who could by discontinuing the performance of their duties throw the whole business of the trust into hopeless confusion. Instances could easily be multiplied, but it is sufficient to point out the distinction.

Union Trust Co. v. Illinois Midland R. R. Co., 117 U. S. 434, 29 L. Ed. 963. No comment seems to be necessary, as the doctrine of that case is in no way opposed to our contention.

Again referring to *Miltenberger v. Logansport,* 106 U. S. 286, 27 L. Ed. 117, so far as the payment of prior accounts was allowed, it was for supplies within ninety days and the allowance was considered a business necessity. It is not an authority at all as to the nature of rights which are equitably entitled to preferential treatment, but is only authority for the proposition that receivership in the course of business must make payment when such payments are necessary to prevent the severance of vital business relations.

Northern Pacific Ry. Co. v. Lamont, 69 Fed. 24. Careful inspection of this case shows that it was in effect for *rent* of a waiting room in North Dakota. The language used is quite general; and if some of it is not within line with the Supreme Court decisions, it must be considered, like the case of *Farmers' Loan & Trust Co. v. R. R. Co.,* 53 Fed. 184, by the same court, as an ill-advised decision.

Union Trust Co. v. Morrison, 125 U. S. 591, 31 L. Ed. 825. The liability did not accrue until after the receivership, and the fact that the bond was signed long prior to the receivership is immaterial. One of the grounds of the decision is that the act of the surety saved the *corpus* of the estate where such *corpus* was in danger by reason of the negligence of the trustee of the mortgage in allowing the mortgagor while in an insolvent condition to continue to operate the road; another circumstance given consideration was the fact that the court had, on the applica-

tion of the receiver *and without objection from the mortgagee,* entered an order for the protection of Morrison, but the receiver had then diverted the income and not protected Morrison. See *International Trust Co. v. Townsend,* 95 Fed. 862, for a discussion of this case.

Southern Ry. Co v. Carnegie Steel Co., 176 U. S. 257, 44 L. Ed. 458. We can see nothing conflicting with our position in this decision. We are quite willing to concede a priority to claims incurred within seasonable time and in the ordinary course of business, for "debts of a railroad company (for current expenses) contracted within the ordinary course of its business." In this case the court considers the amount of the purchases of rails in comparison to the length of lines controlled by the railway company and the condition of the tracks, and considers that such purchases were made in the ordinary course of business.

Bellingham v. N. W. Ry. 49 Pac. 515. The doctrine we have under consideration is the doctrine of the Federal Courts and we do not consider that the Washington cases are authority. However, the Court will note that the equity arose because of the negligence of the trustee to take possession through the medium of a receivership or otherwise. This principle was applied in a number of the cases, among others the Morrison case, but it is not applicable here because the record shows that the receiver was appointed as soon as a receiver could be appointed after the default in the payment of the interest.

St. Louis Trust Co. v. Riley, 70 Fed. 36. No preference was allowed, and the statements of Judge Sanborn are therefore in the nature of *dictum.* Coun-

sel underscores the language that the claim must be founded upon supplies or services which either *preserved or enhanced* the value of the security of the mortgage debt, but it is easy to find general discussions of any legal proposition which does not with nicety distinguish various differences which arise in applying the doctrine but are not under consideration when the particular language is used. The Court will discover this very well illustrated by examining the case of *Illinois Trust & Savings Bank v. Doud,* 105 Fed. 123, where Judge Sanborn, discussing a case which involves the question of whether an improvement or construction item is entitled to preference, very fully expresses his views, which are entirely out of line with appellant's contention. We respectfully request the Court to read the whole of the *majority* opinion, being that of Judge Sanborn. We think this opinion is one of the most valuable opinions in the books, not for what the dissenting judges say but for what the majority judges decide and say. It contains a summary up to that date of the law on many questions which arise in this case.

Loveland v. Blair, 222 Fed. 210. This is a case in which there has been a prior order for payment of operating claims entered. The question was principally whether the claimants were within the terms of the order. There was some discussion as to the diversion theory, but no diversion was shown. We see no value in the case, as bearing on any question in this matter.

Toledo Ry. Co. v. Hamilton, 134 U. S. 296, 33 Law Ed. 905. In this case the Supreme Court declined to allow preference for the construction of a dock, notwithstanding the "consequent improvement

of the mortgaged property." It is wholly an authority supporting our contention that improvements as distinguished from repairs are not entitled to preferential treatment.

In *Union Trust Co v. Souther,* 107 U. S. 594, 27 L. Ed.488, the court appointing the receiver had required the payment of labor and supply bills incurred within six months prior to the appointment. Thereafter instead of so applying the income the whole net amount thereof was used "in purchasing additional grounds and making permanent repairs and improvements." The Supreme Court held that the lower court had not intended to disturb or change the order of appointment in that it required the payment of labor and supply credits, and that they were entitled to payment in accordance with the terms of the original order of appointment. We are unable to discover any theory on which this case is an authority opposed to any of our contentions.

The cases cited on page 16 of appellant's brief may be briefly referred to.

Central Trust Co. v. Wabash Ry. Co., 30 Fed. 332; this case does not involve any question with which we are now concerned.

In *Trust Company v. Clark*, 81 Fed. 269, the court seems to have considered a gear wheel and pinion as an item of repairs.

Manhattan Trust Co v. Sioux City Cable Co., 76 Fed. 658, and *Ry. Co. v. Wilson,* 138 U. S. 501, are cases where a power bill was allowed as a current supply, and where attorney's fees to a small amount, about $300, were allowed, the latter upon the equitable principle that the attorneys had brought to a

receiver certain property and were entitled to an equitable lien thereon. The Manhattan Trust Company case is also stated by appellant under sub-head 5 to uphold an allowance for an electric generator. The statement is true, but the allowance was not on any equitable principle but because the claimant had rights under a conditional sale contract.

In *Cleveland, etc., Ry. Co.*, 86 Fed. 73, the claim allowed was not for the *construction* of a railroad bridge, but for *repairs* on a railroad bridge. It is of course in line with our cases.

We do not have access to the following case, *Atkins, 3 Hughs*, 307

Farmers' Loan & Trust Co. v. American Waterworks, 107 Fed. 23, is not in point. Judge Sanborn declines to allow a preference upon the principle herein sought to be invoked in this language:

> "The contention of counsel for the intervenors that one who furnishes materials that are required to *construct* a necessary improvement or extension of a mortgaged plant of an operating public or quasi-public corporation, thereby acquires an equitable lien on the income earned subsequent to the appointment of the receivers in foreclosure, superior to that of the mortgage bondholders, cannot in my opinion be successfully maintained." (p. 26)

After citing the cases on the doctrine under consideration and on page 31 the court does allow the claim as *against certain moneys earned prior to the appointment of the receiver* on behalf of the mortgage bondholder and collected by the receiver. We do not have that question here.

We believe that none of the cases cited by the

appellant on this branch of the case are inconsistent with the position which we take.

III.

The mere fact that a franchise requires construction or betterments or that the value of the mortgaged property was increased, does not entitle claimant to preference.

Counsel has cited no cases where preference has been given because franchises of the corporation would be lost unless certain improvements were made. The Court will find an instructive case on this point and on many of the points involved in this case in

Illinois Trust Co. v. Doud, 105 Fed. 123,

where it was contended that the building of a new power house was necessary to prevent a franchise from being forfeited. In that case, as in this case, the defendant company had three different classes of business. Judge Sanborn found that the petitioner had met the burden of showing that the new building and machinery were necessary to enable the railway to continue furnishing electric light to the city (though it could have continued all its other business without them) and the court nevertheless declined to award preference. This case is also clearly in point on the proposition that the mere fact that the property was bettered or its value increased is not any reason for sustaining appellant's petition.

Rodger Ballast Car Co. v. Omaha, etc., 154 Fed. 629, is a case where the Ballast Car Company sought a preference because re-ballasting of the road was necessary as the Public Service Commission had threatened to discontinue traffic on the road unless it was re-ballasted. The requisite ballast cars were

sold by the intervenor. Under the facts disclosed in the case there is no doubt that the claim was a meritorious one in itself; that the supplies were necessary to prevent traffic being discontinued and that the bondholders would get an additional value because of the cars furnished by the Rodgers Company. Claim of preference was disallowed *because the claim was not for current operating supplies.* This case is analogous to the claim of appellant in the case at bar in that the right to continue to do business was preserved by the furnishing of the ballast cars. The two cases just referred to will be taken up again in the course of this brief. They are both leading cases and fully discuss the doctrine which is here under consideration.

State Trust Company v. Kansas City, 129 Fed. 455, is one where the U. S. Circuit Court for the Western District of Missouri refuses to allow preference for equipping cars with air brakes, though such equipment was required by Act of Congress.

IV.

Preference allowed only for current supplies, exclusive of betterments and exclusive of new construction or reconstruction.

An examination of our summary or classification of the various items of material furnished will show, we believe, that the materials furnished by the appellant consisted of service extensions, main extensions, betterments and reconstruction items. We believe that the courts have established that service extensions of a gas or water plant are just as necessary to make a complete plant as any other part of the construction. We therefore assert that service

extensions are not to be considered as repairs or maintenance, but as construction items.

The same principle clearly applies to extensions, as for instance, the extensions to the Spokane, Portland and Seattle shops at Vancouver. Under the authorities expenses for extensions are distinguished from expenses for current supplies. The same principle, of course, will apply to the extensions at Centralia, at Kelso and at Chehalis. Furthermore, the authorities which we herein cite are convincing that anything which is in the nature of a betterment as distinguished from a mere current supply, is not entitled to preferential treatment, and furthermore, that the replacing of worn out equipment on any extensive or elaborate scale at all, amounts to a reconstruction and is in no case within the catagory of repairs. From a survey of these cases and independent of the element of time, and the other circumstances of this case, the claim of the appellant ought to be disallowed. Moreover, the record shows that prior to the appointment of a receiver herein, the gas plant at Vancouver, and the water plants at Chehalis, Centralia and Kelso were disposed of and it is herein sought to impound the earnings of the receivership from other plants to pay bills for those plants (Amended bill Exhibits D and E, Stipulation A-1.)

Rhode Island Locomotive Works vs. Continental Trust Co., 108 Fed., p 5. This was a claim for the value of twelve locomotives. They of course increased the value of the mortgaged security but were disallowed because they were not a current operating charge but were an addition to the equipment.

The locomotives were to be paid for in monthly installments.

Central Trust Co. vs. Colorado Ry., etc., Co. 200 Fed., 85. A claim for furnishing and installing boilers was disallowed because it was made with a view to the extension of the business of the concern rather than for present use.

Thomas vs. Western Car Co., 149 U. S., 95, 37 L. Ed., 663, where car rental was held not to be a preferred debt.

Lackawanna Iron & Coal Co. vs. F., L. & T. Co., 176 U. S., 298, 44 L. Ed., 475, where a claim for the purchase price of rails "imperatively required to make a railroad safe for the transportation of persons and property" will not be deemed current debt which may be paid out of the current receipts of a railroad company in preference to a mortgage debt, if the repairs to the road made to be put in proper condition are so extensive as to amount to a reconstruction or the construction of a new road. This case merits careful study. We think that the doctrine of the Supreme Court here expressed absolutely demonstrates that reconstruction items (as (f), (h) and (p) our classification), cannot be allowed a preference.

Toledo R. R. Co. vs. Hamilton, 134 U. S., 296, 33 L. Ed., 905, where claims for the construction of a dock, admittedly improving the mortgaged property, were denied, the court stating that "the equitable principles of the cases heretofore discussed had no application. The work which Hamilton did was *original construction* and not in keeping up as a going concern a railroad already built. The amount due him was no part of the current expenses of op-

erating the railroad. *There was as to him no diversion of current earnings for the payment of current expenses."*

Mr. Justice Brewer cites and approves the case of *Porter vs. Pittsburg & Bessemer Steel Co.,* 120 U. S. 649, 30 L. Ed., 830, where the claims were denied, because for original construction instead of for current operating expenses.

Both of these cases also show that *there can be no diversion in favor of the bondholders as against a creditor* whose claim is for construction. See also, as illustrative of the rule that it is immaterial that the work done has tended to conserve the railroad or enhance the property to the mortgagee, the case of *International Trust Co. vs. Townsend,* etc., decided by Judge Lurton and Judge Taft of the 6th Circuit, July 5, 1899, 95 Fed., 850 op 859, 863.

In the case of *Reyburn vs. C. G. F. & L. Co.,* 29 Fed., 561, the court disallowed a claim for meters because meters are not a current necessity but were in the nature of construction. They are rather new equipment constituting an addition or extension of the business. The language of the court in part is as follows:

> "The debt was wholly contracted for gas meters, which were a part of the gas works of the company and as much required for the complete and operative construction of the works as any other part of the plant or machinery of the works. It is impossible as the proof shows for the gas company to sell gas without meters with which to measure and distribute it to their customers and from which the accounts are to be made up and the bills collected. *It seems to me that it requires meters to make the works of the gas company*

complete as much as pipes and generators, and no gas works can be said to be in operating condition unless they have an adequate supply of meters. The claim therefore comes within the definition of a claim for material furnished for the construction of the works and from the decision of the Supreme Court of the United States in Fosdick vs. Schall, 99 U. S. 235, down to the present time, I have seen no case which contemplates, except under very peculiar circumstances, that general creditors who have furnished more material for the construction of works of this character are to have a lien, as against the lien of the mortgagees."

Discussing this and other claims after holding the claims to have accrued more than sixty days prior to the appointment of the receiver and therefore too old, the court says:

"But a more conclusive and satisfactory reason to my mind why these claims should not be allowed, is that none of them are operating and supplying claims. *They are all for constructive material, such as meters, pipes and other material which* was used in the construction of the works and not in their operation after they are constructed."

This case is on all fours with the instant case, particularly with reference to the connections with customers in both the gas and water plants. The case exactly fits the items (a) and (b) of our classification.

The *Reyburn* case is in accord with accounting practice which charges service extensions to *capital* and not to operation.

City Trust Company vs. Sedalia, 195 Fed., 845; claim for expense of a flagman—not allowed because not an operating expense.

The Decisions Applied

Applying the cases to the facts as summarized by us in this brief, we submit the *Reyburn* case, 29 Fed., 561, especially applies to the items of (a) and (b) our classification; and the *Doud* case, 105 Fed. 149, to (b); the *Thompson* case, 132 U. S. 68, the *Hamilton* case, 134 U. S. 296, the *Reyburn* case and the *Rhode Island Locomotive Company* case, 108 Fed. p. 5, specially apply to the items under the heads of "Main Extensions" and "Betterments;" the *Lackawanna* case, 176 U. S. 298, specially applies to the items under the head "Reconstruction." The other cases cited by us and many of the cases cited by appellant, all tend to establish—and taken as a whole they do establish—the proposition with which we started, that preference is allowed for supplies used for *necessary operating purposes* and is not allowed for construction, including in this term extensions, betterments, improvements, additions to equipment, etc.

V.

There can be no diversion except against those claims entitled to preference.

The bill of complaint shows that interest is paid up to October, 1913. The stipulation is an admission that in addition to the interest thus paid, there was net operating income sufficient to pay the claim of Crane Company. This is not an admission that there has been any diversion but leads to the conclusion that if the appellant is otherwise entitled to preferential treatment it is not precluded because there is no fund.

There can be no diversion as against those claims which are entitled to a preference. Of course

it is not a diversion to pay interest if the bondholder is entitled to the payment of interest in priority to the claim of the creditor claiming that such diversion exists.

> *Toledo R. R. C. vs. Hamilton,* 134 *U. S.* 296, 33 *L. Ed.* 905 *supra;*
>
> *Porter vs. Pittsburg, etc., Co.,* 120 *U. S.* 649, 30 *L. Ed.* 830 *supra.*

The idea of diversion implies that something wrong has been done, but nothing wrong has been done by the payment of interest if the bondholder is entitled to his interest more than Crane Company is entitled to its payment; so that to assert that there has been a diversion is to assert that Crane Company is prior in right to the bondholders, which is the question to be decided.

The mere fact that interest has been paid or improvement made does not entitle the claimant to a preference.

> *Rhode Island Locomotive Co. vs. Continental Trust Co.,* 108 *Fed.* 5;
>
> *Rodger Ballast Car Co. vs. Gas Co.,* 154 *Fed.* 629;
>
> *Central Trust Co. vs. Colorado Co.,* 200 *Fed.* 85.

In the case last cited the court says—before rights to a preference is established it must be shown:

> *"First, that the claim has been part of the current expenses in the regular course of business, and second, if such, there must have been a diversion of the net income (from which current expenses are properly payable) to betterments, interest charges, or other purpose beneficial to the mortgage creditors,* thus detracting from

claimant's equity to the fund and thus calling for reparation out of the sale of the property. The facts of the present case do not bring the claim whether accruing before or after May 16, 1911, within either, much less both, of the essential conditions last named." (Our italics).

Evidence that interest has been paid or improvements have been made out of the income is germane only as establishing that *if the claimant is otherwise entitled to a preference* there is a fund from which payment can be made to it. There is no conflict in the cases on this point, but counsel has quoted from certain of the opinions of the Federal Courts, language which taken alone might lead to the conclusion that the mere fact of diverson or the mere fact of payment for interest or for improvements would entitle a creditor to preferential treatment. No detailed discussion is necessary to demonstrate that this is not the law, as it has never been asserted to be the law by the courts and is not a part of the doctrine under which claimant seeks preferential treatment. See on this point *Thompson vs. R. R.,* 132 U. S., 68.

In his subdivision V, beginning at page 36, appellant makes brief reference to the income of the receivership. The Court will note that by an error the brief states that the receiver collected a net income of $123,000.00,—this amount should be $23,000.00 instead of $123,000.00. Counsel argues from this fact that this amount should have been used for the payment of appellant's claim. The same stipulation (Transcript page 79) shows that during all of the period of the receipership no interest was paid on either the first or the second mortgage, and in claiming that this money should have been used to pay the appellant, counsel is begging the question

which is,—Whether appellant's claim is entitled to priority over the bonds. Furthermore, the amended bill of complaint shows that the mortgagor was indebted to general creditors to the extent of more than $50,000, Par. 23, and in asserting that the net earnings of the receivership should have been applied to the payment of the appellant's claim, appellant is assuming that the rights of the other general creditors are inferior to that of the appellant.

On pages 46 and 47 of its brief appellant makes some statements which are so far from sustained by the record we feel bound to take notice of them. According to these statements Crane Company

> " * * * came forth at a time when the company was in danger of losing its franchises, when its property had become debilitated, when it was necessary to make extensions, lay new mains and otherwise comply with its franchises * * * Furthermore, to magnify the inequity and add a grim irony to the situation, the mortgage bondholders were, during this time, taking and receiving money from the corporation that, under all of the authorities, equitably belonged to Crane Company * * * In the receiver's report filed herein it will be found that the estimated value of its properties is given in such an amount as to clearly indicate that what Crane Company put in increased the value of the properties more than tenfold."

These statements are extraordinary, and if the records sustain them, would be very remarkable. It may be said in passing that the receiver's reports are not in evidence for the purpose of showing the value of the properties under the receivership, nor is it recalled that the receiver ever attempted to value the properties, but if it could be demonstrat-

ed that the $11,000.00 "put in" as counsel says by Crane Company, multiplied the value of the Washington-Oregon Corporation holdings by ten, Crane Company certainly would be entitled to consideration, though not in this case, even then. If, for instance, the holdings of the Company were increased from $100,000 to a million dollars by the expenditure of $11,000, the person expending that $11,000 would be entitled to some consideration though he would not be entitled to the relief asked in this proceeding. Of course these statements are not true, and they are not sustained by the evidence. It is only true that the bondholders got their interest for a period during which the appellant got out nine-tenths of the principal of its claim, so that while the appellant make a healthy profit on furnishing goods to the Washington-Oregon Corporation, the bondholders who advanced their money on the faith of presumed mortgage security, stand to lose the principal. The record further shows that appellant received payment of one note (about $2,300) just prior to the receivership. (Transcript p. 31.)

VI.

In the absence of special circumstances claims otherwise entitled to preference will be allowed such preference for six months only prior to the appointment of a receiver.

The remarkable doctrine asserted by counsel under Subdivision III of his brief, beginning on page 31, does not seem to be entitled to detailed discussion. This doctrine is that regardless of time if the creditor comes within the designated class it is entitled to priority. The assertion that such is the law is attempted to be bolstered up by quoting from *Fos-*

dick vs. Schall, where claims accruing within six months were not allowed; and Fosdick vs. Southwestern Car Company, where cars belonging to the petitioner were held to still belong to the petitioner notwithstanding the foreclosure sale; by the case of *Moore vs. Donahoo,* 217 Fed. 177, where claims were allowed which accrued *within six months;* and from several other cases, in none of which did the claims accrue more than a year prior to the receivership. Counsel's contention appears to be that because time was not considered, therefore the claims would have been allowed even though they had accrued a good while prior to the time when they did accrue. As an example of a *non sequitur,* this contention is *par excellence.* We are content to forego any further comment upon this strange theory. We think it sufficient to quote the following language of Judge Sanborn in *Westinghouse vs. Kansas City So. Ry.,* 137 Fed., 26, to-wit:

> "Mortgage bondholders have the right to the payment by the mortgagor of the current expenses of the operation of the railroad by their debtor with reasonable promptness. The reason that six months is approximately the limited time within which preferential claims must accrue is that there is usually an interval of six months between the dates when installments of interest upon the bonds fall due, and the mortgages generally provide and the warranted inference is, that, when an installment of interest is paid, current expenses to that time have either been paid, or funds to pay them have been lawfully provided. The failure of the Gulf Company to pay this debt of the petitioner in November, 1897, when it was due, was a violation of the covenant in its mortgage, unless the creditor released its paramount lien, and thus withdrew its

claim from the class of claims covered by that covenant from the class entitled to a paramount lien.

"The approval of the extensions of the times of payment of preferential claims by agreements, between the debtor and the claimants which are not placed on record and are generally unknown to the bondholders and their trustees, would enable simple contract creditors to pile up large debts of the mortgagor secured by secret liens paramount to railroad mortgages, *would permit them to thus impair the security and to evade the legal effect of the contracts contained in the mortgages, and, by concealing the actual defaults of the mortgagor, would allow them to indefinitely deprive the bondholders of the possession and application of the property to the payment of their bonds and coupons until their security might be practically destroyed.* (Citing cases.) In Morgan's, etc., 137 U. S., 171, 196, 11 Sup. Ct., 61, 69, 34, L. Ed., 625, Mr. Chief Justice Fuller, in delivering the opinion of the supreme court upon the question whether those who, like the petitioner, assist in the diversion of income to the payment of interest and thereby prevent defaults which entitle the bondholders to the property, may enforce liens paramount to that of the mortgage, said:

'By the payment of interest the interposition of the bondholders was averted. They could not take possession of the property, and should not be charged with the responsibility of its operation. It is true that a railroad company is a corporation operating a public highway, but it does not follow that the discharge of its public excuses it from amenability for its private obligations. If it cannot keep up and maintain its road in a suitable condition, and perform the public service for which it was endowed with its faculties and franchises, it must give way to

those who can. Its bonds cannot be confiscated because it lacks self-sustaining ability. To allow another corporation, which for its own purposes has kept a railroad in operation in the hands of the original company, by enabling it to prevent those who would otherwise be entitled to take it from doing so, a preference in reimbursement over the latter on the ground of superiority of equity, would be to permit the speculative action of third parties to defeat contract obligations, and to concede a power over the property of others which even governmental sovereignty cannot exercise without limitations."

Counsel's brief shows that within the six months period appellant furnished goods to the value of $56.03; within fifteen months it furnished goods to the value of $3,038.00; and within two years and three months it furnished goods to the extent of $6,169.41; within three years to the extent of $58.23; and within three years, three months, goods to the extent of $195.89.

While it is perhaps not very material, we think our division a more natural one. From the amended petition itself it will be seen that the materials for which claim is made were furnished during the following periods prior to the appointment of the temporary receiver (July 31, 1914.)

$56.03 within 6 months prior to the receivership.

$0000 in more than six months and within one year.

$3,038.01 more than one year and within eighteen months.

$45.65 more than 18 months and within two years.

$7,898.64 more than two years and within 2 years 6 months.

$58.23 more than two years and six months and within 3 years.

$195.89 more than 3 years and within 3 years and 3 months.

Before discussing other cases, we desire to briefly consider some of the cases cited under the heading of "time" (subdivision VI) by appellant. We think that the excerpt from *Southern Ry. Co. vs. Carnegie Steel Co.*, 176 U. S., 257, 292, found on page 42 of the brief, states the rule. Doubtless there is no six months rule in the sense that the courts will under all circumstances enforce that limitation, but there is such a rule in the sense that ordinarily that is the limit of time beyond which the courts will go. Like most rules predicated principally upon the discretion of the courts, there must be some elasticity; and if a claim appeals to the equities to a sufficient degree and if there is some special reason why the limitation of six months should not be enforced, the courts have in a number of instances extended that limitation. An inspection of the cases referred to by the appellant as showing the most favorable limitation of time which has been allowed by the courts, will convince the court, we think, without argument, that this case is not within the most favorable construction of he rule.

In the case of *New York Guaranty & Indemnity Co. vs. Tacoma Railway, etc., Co.*, 83 Fed. 367, cited on page 48 of the brief, the court will note that the time allowed was actually less than a year, the time during which litigation was pending to establish the claims being excluded by the court from consideration. Excluding this time, the claim ran less than twelve months, though by an error in the court's opinion (which error is shown by reference to the

statement of facts as to when the cable was sold), the time would appear to be a few weeks more than a year. This case involved only a few hundred dollars and the doctrine was not exhaustively considered, and the case cannot be considered as establishing that this Circuit has adopted any other or different rule from the rule adopted by the Supreme Court and by the other Circuits.

Hale vs. Frost, 99 U. S., 389. Time was nowhere considered or discussed. The interest due on the bonds defaulted a few months after a balance was struck between intervenor and mortgagor, but the bondholders funded their coupons then, and at the following interest periods until just prior to the time foreclosure was begun, and a receiver appointed. If time had been considered this fact would have been a sufficient reason to distinguish the case from the instant case. The case is, however, authority for the point that construction items cannot be allowed.

Trust Co. vs. Morrison, 125 U. S. 591, 31 L. Ed. 825. As heretofore stated, the liability of the surety was not fixed until after a receiver was appointed and it is not authority for any claim extending back of the six months period.

Southern Railway Co. vs. Carnegie Steel Co., 176 U. S. 257, 44 L. Ed., opinion 473. The supreme Court held that a preference might be allowed

> "although the contract for the rails was a few months back of the six months immediately preceding the receiver's appointment. * * * No absolute rule on the subject has been prescribed by statute or by judicial decision. A claim accruing back of the six months immediately pre-

ceding the appointment of a receiver may under the circumstances of the particular case be accorded the same priority in the distribution of earnings that belongs to like claims arising within that period. Touching this question of time and the principles upon which the equitable rights of creditors in such cases as this rest, Mr. Justice Brewer said, in *Blair vs. St. Louis, etc., R. R. Co.*, 22 Fed. 471, 474:

'The idea which underlies them I take to be this: that the management of a large business like that of a railroad company cannot be conducted on a cash basis. Temporary credit in the nature of things is indispensable. Its employes cannot be paid every month; it cannot settle with other roads its traffic balances at the close of each day. Time to adjust and settle these various matters is indispensable. Because in the nature of things this is so, such temporary credits must be taken as assented to by the mortgagees. In this view, such temporary credits accruing prior to the appointment of the receiver must be recognized by the mortgagees and such claims preferred. * * * There is no arbitrary time prescribed and it should be only such reasonable time as, in the nature of things and in the ordinary course of business, would be sufficient to have such claims settled and paid. Six months is the longest time I have noticed as yet given. Ordinarily I think that is ample. Perhaps, in some large concerns, with extensive lines of road and a complicated business, a longer time might be necessary.' "

Farmers Loan & Trust Co. vs. K. C. W. & M. Ry. Co., 53 Fed. (op. 187). In this case Judge Caldwell quotes from a letter of Judge Brewer's in which the language referred to in appellant's brief is used. There was no contest as to the claims. If there had been a contest, Judge Brewer, in a letter, *thought*

that this would have been his decision. In this case as appears by the statement "most" of the claims "were contracted not many months before the filing of the bill."

Bellingham Bay Imp. Co. vs. Fairhaven, etc., Ry. Co., 49 Pac., 514. This is not a Federal Court case and is not in line with the rule as established in the Federal Courts.

We do not give special attention to the cases referred to by counsel where the court did not consider time as an element. If the court did not consider it an element, certainly the decision is not of much value on the question of time. An inspection, however, of the cases will show that the Supreme Court has allowed claims accruing prior to the receivership for the following periods: *Trust Company vs. Morrison,* accrued *subsequent* to the receivership; *Burham vs. Bowen,* 111 U. S. 783, 28 L. Ed. 596, accrued within eleven months; *Gregg vs. Metropolitan Trust Co.,* 197 U. S. 183, 49 L. Ed., 717, accrued withinn six months; *Fosdick vs. Schall,* accrued within six months.

We note the following illustrative cases, in many of which time is considered and determined:

Bound vs. Railway Co., 58 Fed. 473, Judge Fuller participating. Claim for eighteen months disallowed. Doctrine discussed and its narrow limitations referred to.

Thomas vs. Peoria, etc., R. R., 36 Fed., Opinon, 819. Six months rule applied.

Thomas v. Cincinnati, 91 Fed. 795. Judge Taft applies the six months rule as against labor claims.

Westinghouse vs. Kansas City, 137 Fed. 41. Judge Sanborn applies six months rule. See also *Chicago Alton vs. U. S., etc., Co.,* 225 F. Ed. 943.

Blair vs. St. Louis, etc., 22 Fed. 471. Six months rule applied by Mr. Judge Brewer.

Finance Co. vs. Charleston R. R., 52 Fed. 678. Claim for legal services rendered two years prior to the receivership was denied, the court saying:

> "Fosdick v. Schall led the way to the displacement of the mortgage lien, permitting certain favored claims to be paid before the mortgage debt either out of the income or out of the proceeds of the sale. But the courts have carefully guarded themselves from extending these claims, which were for materials, supplies and labor necessary for keeping the railroad a going concern, *and have expressly refused to consider any claim originating more than six months before the appointment of receiver.*"

And on page 679 the court holds that it does not help the claim that the bondholders were benefitted.

International Trust Co. vs. T. B. Townsend, 95 Fed. 850. This case, decided by Judge Lurton, with Judge Taft a member of the court, sustains the six months rule in its entirety, and disallowed claims back of that period. The court also holds that the fact that the supplies increased the value of the road is immaterial. We invite attention to the case.

National Bank of Augusta vs. Carolina R. R. Co. 63 Fed. 25.

> "This period (preferential period) never is beyond six months, but in exercising this equity the court goes upon dangerous grounds and there-

fore proceeds cautiously, keeping rigidly within prescribed limits."

In *Thomas vs. Peoria,* 36 Fed. 808, *supra*, decided by Judge Harlan of the 7th Circuit in 1888, all claims for car rental were disallowed which had been accrued more than six months prior to the receivership, regardless of the fact that diversion had been made of the current income. The court used this language:

"The general rule that has obtained in this circuit for many years, though not fully or expressly formulated in any public decision, has been not to charge the income of mortgaged property accruing during a receivership or the proceeds of the sale of such property, with general debts for labor, supplies and equipment back of the six months immediately preceding the appointment of the receiver. While the court has not perhaps committed itself against applying a different or more liberal rule when the special circumstances or equities of the case demand such a course, the general rule is as just stated; and I am unwilling in this case and at this late date to depart from it, besides I am of the opinion that under the circumstances that usually attend the administration of railroad properties by courts through receivers, the rule stated is a wise and salutary one. It would not do to charge the income of mortgaged railroad property managed by a receiver, or the property itself, with every debt incurred in all its previous history for labor, supplies or equipment."

After observing that the six months rule finds support by analogy in the statute of Illinois giving a lien upon railroad property for labor and supplies, the court continues:

"It may be added that the grounds upon which

the court may charge the income of mortgaged railroad property earned during the receivership with debts for labor, supplies and equipment received prior to the appointment of the receiver, are so fully stated in some of the cases cited.—particularly in *Fosdick vs. Schall*—that further discussion of them is unnecessary, but I will say that the six months rule was observed by me at the circuit, when disposing of the case of *Trust Co. v. Railway Co.,* and the final decree, so far as it rested upon that rule, was not disturbed by the Supreme Court."

In the case *of Central Trust Co. v. East Tennesee R. Co.* 80 Fed. 624, decided by Judge Lurton of the 6th circuit in 1897, a claim for certain supplies furnished a railroad more than six months before the receivership was presented and refused. It was shown by claimant that net earnings had been diverted to the payment of interest on mortgage debts and to the improvements. Answering the claimant's demand that it be paid out of the corpus of the property to the extent of such diversion, the court said:

"In this circuit a six months rule has been almost universally imposed and a large number of insolvent railroad companies have been wound up and their property distributed among creditors under general orders so limiting the payment of such claims * * * as these receivers were appointed January 24, 1892, it will be noticed that this limitation was practically one of six months; January 1, 1892, being fixed as a date more convenient to adjust said claims, than one falling so near the end of the month and of a year as a date precisely six months before the receivership. The appellants present no special circumstances which will justify a departure from this general order under which all such claims have been settled. We feel altogether in-

disposed to arbitrarily extend the limit imposed in the sound discretion of the Circuit Court."

In the case of the *International Trust Co. vs. Townsend & Co.,* decided by Judge Lurton in the 6th circuit in 1899, 95 Fed. 850, *supra,* the claim was presented for building a pier and certain drawbridge abutments. In refusing the claim the court said:

> "If on this statement of facts this debt be regarded in the ordinary business of operating a railroad and in the expectation that it would be paid out of the current earning of the railroad, only such of the debt as accrued within six months prior to the appointment of the receiver should have been held as a charge upon the surplus income of the receivership * * * In this circiut six months has been generally regarded as a sufficient time to go back and charge such claims upon the income of a receivership, and this court gave its approval to that rule in the case of *Belknap vs. Trust Co.,* 47 U. S. App. 663 and 80 Fed. 624. There was no reason for departing from the time limit under which the court had administered this receivership."

It will be observed in this case also that the rule was stringently applied to a claim, a part of which was for labor.

In the case of *Guaranty Trust Co. v Galveston City R. Co.,* 107 Fed. 311, decided by Judge Toulmin of the 5th circuit in 1901, three claimants who had furnished supplies admittedly necessary to the continued operation of the railroad were refused upon the ground that the supplies had not been furnished within six months of the receivership.

We submit that an examination of paragraph 2 of the stipulation herein will show that not only the character of the claim, but the circumstances under

which it accrued, were very similar to those of the case above referred to. In both instances all the materials had been furnished more than six months previous to the receivership, the most of the indebtedness was evidenced by promissory notes coming due after the appointment of the receiver and there was a small running account which had accrued shortly previous to the receivership, unevidenced by any notes.

We also call attention to the case of *State Trust Co. v. Kansas City R. Co.*, 129 Fed. 455, decided by Judge Phillips of the 8th circuit, 1904. The claim here urged was that of the Westinghouse Co., for having supplied the railroad with air brakes. It will be here observed that there had been a diversion of current income for the betterment of the railroad property. It will be observed also that the improvement here made was rendered necessary under an Act of Congress. The supplies in question were furnished more than a year previous to the receivership. The court had extended the period of priority to one year. Notwithstanding the diversion of current income, and the character of the supplies and the necessity for their use, the court refused priority to the claim. We call special attention to the language of the court, p. 458:

> "The period of six months is ordinarily recognized by the Federal Courts as just and reasonable time within which a claim must have accrued, to entitle it to preference over the mortgage; and while it is not an inflexible rule, and the court may reserve to itself to allow a longer time where the equities of the case absolutely demand, there certainly *ought to be some special equity to give this particular alleged lienor an*

extension beyond the six months period recognized in paragraph 6.

"Speaking for myself, who joined with Judge Thayer in making the decree in question, the twelve months period was deemed most liberal to the creditors. And, as this court knows that all the claims imposed upon the purchaser of this road have been adjusted upon the twelve months limitation period, it can see no special equity in favor of this intervenor who represents the last unadjusted claim, having accorded to it, as the Master has, a period of 18 months anterior to the appointment of the receiver, even if the claim should be found entitled to the preference asserted."

In *Moore vs. Donahoo,* 217 Fed. 177, the Circuit court of appeals of this circuit recognized the six months rule, though it was not apparently in controversy.

In *Title Insurance Co. vs. Home Telephone Co.,* 200 Fed. 263, the rule was recognized in this district although it was not in controversy in that case. In that case also this Court disallowed the claim of the president of the company for salary during the six months because it was not a current expense.

In reviewing the whole field of decisions, it may be safely said that not only has a six months preferential period been acknowledged and followed by the Supreme Court but by every Circuit of the United States. It may further be safely said that of the numerous learned judges who have applied the doctrine, only Judge Caldwell of the 8th circuit has, as evidenced by his decision in *Farmers Loan & Trust vs. Kas. City, etc., R. R. Co.,* 53 Fed. 182, and in *N. P. Ry. Co. vs. Lamont,* 69 Fed. 23, shown himself to be a consistent opponent of the doctrine.

The overwhelmiing authoriity in all of the United States circuits and in the Supreme Court, is that regardless of how well a certain claim may stand the test of priority otherwise it cannot in the absence of special equities be allowed if it has accrued more than six months previous to the receivership. The claim here urged has no stronger evidence in its favor than scores of other urged and disallowed in the numerous decisions above noted. If the claim of the Crane Company is allowed a preference notwithstanding the fact that all of it, except a part so small as to be unconsidered, arose more than a year ago and by far the largest part of it more than two years ago,—then it may as well be regarded as the law that secured claims must give way to unsecured claims. If the reason of the rule is as stated by Judge Brewer in *Blaïr v. St. Louis,* 22nd Fed. 471, that in the ordinary course of business large corporations cannot transact their business with such promptness that it is reasonably to be expected that their current bills will be paid as promptly as is the case with individuals, and that six months is ample for most large corporations, then in this case, where the corporation compared to that in most is a very small one, the rule would certainly not be enlarged. If the reason of the rule is as suggested by Judge Sanborn in 137 Fed. 40, *Westinghouse vs. Kansas City R. R.*, that in six months ordinarily interest will become due and the bondholders can assume that claims otherwise entitled to preference but not enforced within that time have waived their rights of priority,—then in this case where the bondholders had proceeded with utmost promptness to enforce their rights, there can be no reason for extending the doctrine.

VII.

It is not settled whether the doctrine is applicable to water companies.

The Court will observe from the facts submitted that the material was furnished by the appellant for purposes in connection with the water works and to a very small extent for the gas works. In determining whether the doctrine applies to this case at all, it is of course immaterial that the Washington-Oregon Corporation was engaged in other lines of endeavor.

At best for appellant it can be said that the question whether the doctrine applies at all in the case of water companies, is unsettled.

Short in his Law of Railway Bonds and Mortgages, page 594, says:

> "But there are other corporations, the position of which with respect to the doctrine is, in the present state of authorities, somewhat difficult to fix. That no preference will be granted to back claims against a waterworks company is settled—a doctrine which seems to involve the conclusion that the power to exercise the right of eminent domain is not a decisive test."

In *Wood v. Garanty Trust Co.,* 128 U .S. 418, 32 L.Ed.472, the Supreme Court of the United States was urged to extend the doctrine of railroad mortgages as expressed in *Fosdick v. Schall,* to a company supplying a municipality with water. The court refused so to do, Mr. Justice Larmer pointing out that "the doctrine of *Fosdick v. Schall* has never yet been applied to any case except that of a railroad."

In *Ford v. Central Trust Company,* 70 Fed. 144,

the Court, in deciding against the priority of unsecured claims against a waterworks company, observed that the doctrine as laid down in the Fosdick case had not yet been applied to corporations furnishing a municipality with water. After declaring that the Fosdick case and other railroad cases were not controlling, the court continues:

> "We recently had occasion to show that the doctrine of these cases had never been applied to any case except that of a railroad. *Hannah v. Trust Co.,* 70 Fed. 2. Assuming, *but not deciding,* that the doctrine of this case is applicable to a corporation under obligation to furnish a city and its inhabitants with water, still the appellant cannot maintain his claim for the following reason," etc.

In *Louisville & N. R. Co. v. Memphis Gas Light Co.,* 125 Fed. p. 97, a mortgage was being foreclosed upon properties of a corporation furnishing a municipality with gas. Here again the Federal Court evidenced its reluctance to extend the doctrine to such corporations as water and gas companies. In citing *Wood v. Guaranty Trust Co.* to the effect that the Fosdick case had never yet been applied in any case save that of railroads, the court observed that "This probably still remains true of the Supreme Court," although some Federal Courts had come to extend it to street railways, telegraph and telephone companies. The court then added:

> "Obviously street railroads and telephone and telegraph companies are similar to railroad companies in a sense gas companies are not. A gas company is more like a waterworks company, which is more of a private concern,—a manufacturing enterprise. It supplies the public convenience but it does not enjoy the same privi-

leges and franchises nor would its stoppage result in that injury to the public and detriment to the mortgage security which would flow from the stoppage of a railroad."

As late as 1909 the Court in *Whelan v. Etnerprise Transportation Co.,* 175 Fed. 214, referred to the refusal of the United States Supreme Court in *Wood v. Guaranty Trust Co.,* to extend the doctrine to water companies, as leaving such extension still "an open question."

There is no decision of the United States Supreme Court, therefore, so far as we are aware, which has extended the doctrine in question to water companies.

The effect of this state of law is not impaired by the fact that the water systems to which the present supplies were furnished, were but branches of the Washington-Oregon Corporation. The properties of such corporation remain at all times separate and distinct. The supplies at most benefitted the water systems only. The power systems and railway systems operated by the corporation remained unconcerned and unbenefitted.

VIII

The Equities of the Case

The frequent allusions of appellant's counsel to the equities of this case induce us before closing our argument to refer very briefly to this subject.

In his discussion of the equities, beginning at page 54 of his brief, counsel refers to the case of *Illinois Trust & Savings Bank v. Doud,* 105 Fed. 123. He states:

"The claim there allowed was for money borrowed that was used in the construction of a

building for the purpose of engaging in an entirely new enterprise."

This statement is an error. The money was used for the construction of a new building in order to add to the power (p. 132). Counsel further states that the man who loaned the money "agreed in the terms of the loan that he should not be paid out of the current revenue until other indebedtness was paid." We cannot find in the statement of the case or in the opinion anything on which this statement is based. There was an express agreement that the money was to be repaid out of the current revenues (p. 126). The new building effected a saving of $4,000 per annum in the operations of the company. It was a distinct benefit to the concern. We do not think that the equities of the case at bar are nearly so appealing as those of the *Doud* case, just referred to, or of the *Rodgers Ballast Car Co.* case, found at 154 Fed. 629, and referred to by counsel on page 57 of his brief, or the case of *Toledo v. Hamilton,* 134 U. S. 296. In fact if there are any special equities in this case, any reason at all why the appellant should be paid over the other general creditors, whose claims amount to more than fifty thousand dollars, they have not been pointed out.

Under this head counsel apparently abandons his contention that the materials furnished by Crane Company were for current expenses. He says that "the materials that were furnished by Crane Company went into and formed a part of the mortgage security not only greatly enhanced the value thereof but in many instances actually reviving security that had become valueless," etc.

Further on page 55 counsel says: "Here the ma-

terials of the intervenor can actually be identified in each instance and are invoiced in the inventory at the present time as part of the corpus of the mortgaged estate.'' The actal theory on which the Crane Company hopes to recover is that (as it claims) the materials furnished by it improved, bettered and added to the value of the mortgage security, as distinguished from constituting current supplies necessary to keep the concern an operating one. As has been shown by the adjudicated cases, particularly those from the Supreme Court of the United States, cited under head "II" of this brief, it is entirely clear that the mere fact, if it is a fact, that the plant of the Washington-Oregon Corporation was bettered furnishes no reason whatever for allowance of preference. That is not the theory on which preferences are allowed.

But counsel says on the same page, fifty-four, while these materials were being furnished the bondholders took sufficient from the current funds of the corporation to have paid Crane Company in full * * "While Crane Company was putting materials into the corpus of the estate for the preservation of the property which inured to the benefit of the bondholders, the bondholders in turn were reaching into the pockets of the corporation and taking money which in equity and good conscience belonged to the intervenor.''

The record shows that the last interest received by the bondholders was in October, 1913. There is no showing that the bondholders had any knowledge that the company was in default in payment of any of its bills at that time. The Washington-Oregon Corporation failed to pay its interest maturing on

the first of the following April. Under the terms of the mortgage foreclosure was not possible for ninety days, that is until the 1st of July, 1914, and within thirty days thereafter the bondholders began foreclosure and asked and obtained the appointment of a receiver. We would like counsel on the argument of this case to point out wherein the bondholders were guilty of any wrong in this conduct. Counsel has stated that "the diversion during the time that this account was accruing was so flagrant as to almost impute bad faith to the bondholders." This statement should not have been made if counsel has no basis for it, and if he has a basis for it in the record we would like to have him point it out explicitly to the Court.

During this period the appellant received almost nine-tenths of its account and the bondholders received no part of the principal of their claims, but did receive interest at six per cent. up to October, 1913. It is not charged by us that Crane Company was guilty of any wrong in receiving money which was justly due to it from the Washington-Oregon Corporation, but Crane Company having received nearly all of its principal ought not to assert that the bondholders were guilty of any wrong in receiving their interest.

Had Crane Company pursued its proper remedy with diligence as it was required to do under the principle of the cases which we have cited, it would either have collected its money or a receiver would have been appointed long before one was appointed. Appellant would not have been asking the equity of the court for a claim nearly three-fourths of which is more than two years old. It was not equitable for

the appellant to allow the Washington-Oregon Corporation to continue to operate leaving unpaid its debts to the Crane Company without effort on the part of the Crane Company to collect and now claim that the income earned during the period of the receivership should be applied to the exclusion of the bondholders upon its payment.

On the one hand we have the appellant, which has sold goods to the Washington-Oregon Corporation with the expectation of obtaining a commercial profit; and, on the other hand we have the bondholders who loaned money to the Washington-Oregon Corporation with the expectation of receiving only the interest upon their money. On the one hand, we have the appellant, which was induced by the hope of obtaining liberal profit to extend credit to the Washington-Oregon Corporation and on the other hand we have the bondholders who declined to advance any money on the credit of the Washington-Oregon Corporation but looked solely to the security of a mortgage upon all of the then owned and after acquired property of the corporation, and the income thereof. On the one hand we have the appellant which allowed its claim to run for years; and on the other hand we have the bondholders, who, within one month of the time when their right to foreclose had accrued, had instituted a foreclosure suit. On the one hand we have the appellant which has presumably made a profit, or has suffered no loss, from its dealings with the Washington-Oregon Corporation; and on the other hand we have the bondholders who have suffered a very heavy loss on their investment.

Indeed, if Crane Company is to receive a prior-

ity over the bondholders, we see no reason why all the unpaid creditors of the Washington-Oregon Corporation should not be accorded a simliar priority; for presumably the materials furnished by, or through the aid of, all these creditors (and their claims amount to many thousands of dollars) meet the test of priority contended for by appellant's course. We are therefore brought to the astonishing conclusion that the position of the unsecured creditors is superior to that of the secured creditors.

We submit that the appellant must fail because its materials do not constitute operating supplies; further, because they were furnished to the water branch of the Washington-Oregon Corporation's business; further, because they were not furnished within the time preceding the receivership within which the courts hold that priority claims must accrue; and, finally, because there is no special equity by virtue of which the claimant has the right to be preferred over other claims and over the contract rights of the bondholders.

Respectfully submitted,

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